CHALK CREEK
PARTNERS

Weekly Update

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Carlisle C. Wysong, CFA
Managing Partner

- The market grinds sideways for a change
- It looks like interest rates are just normalizing
- Even the inflation data is confusing
- Housing is still rolling despite interest rates
- Damn, it is cold! GameStop has nothing on spot Natgas prices!
- Chart Crime of the week

	Last	5d %	YTD %	1yr %
SPX	3902	-0.3%	3.9%	17.6%
QQQ	330.6	-1.2%	5.4%	41.9%
US 10 YR	1.29%	1.13%	0.92%	1.57%
VIX	23.5%	22.0%	22.8%	14.4%
Oil	61.08	4.6%	25.9%	17.5%

*10yr and VIX are levels not changes
** Oil is front month futures, beware

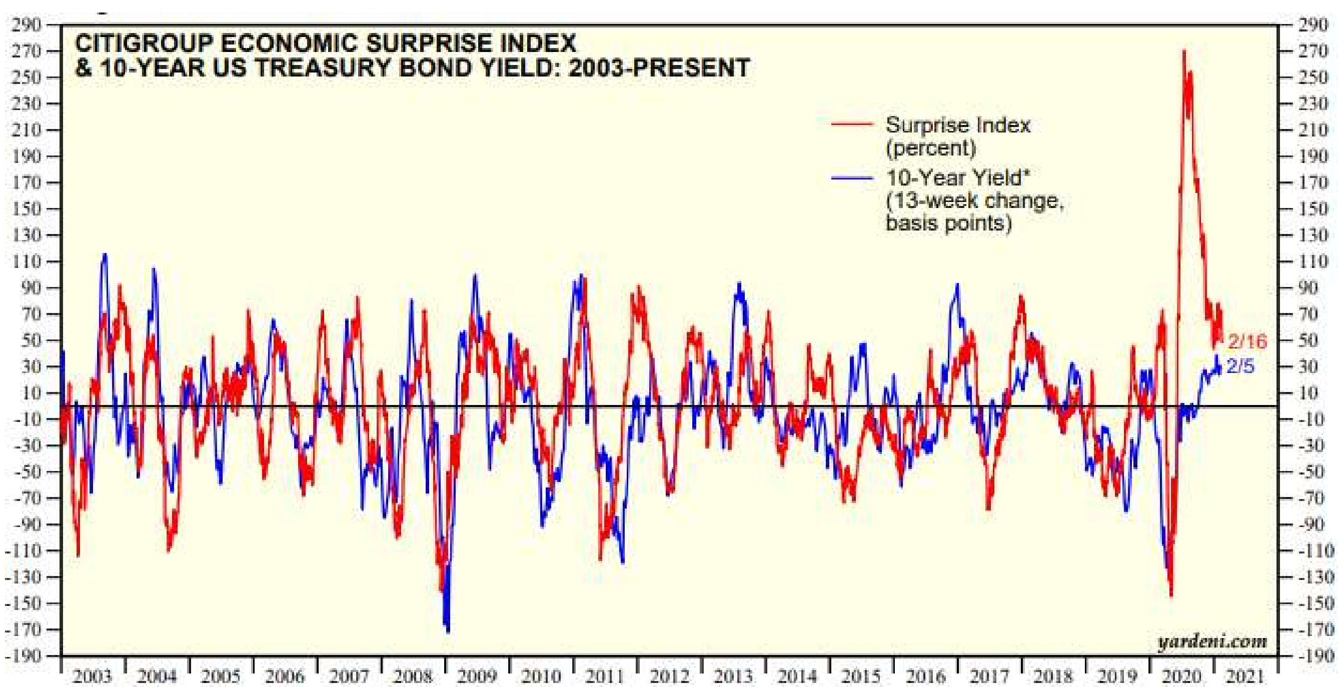
The market cannot seem to make up its mind on direction or rotation. Thus, we had a rare flat market for the week (this morning's weakness notwithstanding). The drivers of the indecision are slightly modified versions of the usual suspects. Foremost is the move higher in 10-year interest rates. Just last week we noted that the market was starting to buy "bond proxies" in the equity market…we even dipped our toe in with the caveat that it is impossible to time interest rate moves. Indeed, it is. So, the question is, does the move higher in rates portend runaway inflation or reflect positive economic expectations? We believe in both to a certain degree. We maintain that inflation will be somewhat limited to financial and "hard" assets like commodities. And we believe the economy will continue to surge ahead despite persistent weakness in the labor market. Ultimately, this does not mean much for our portfolio. We will keep our balanced barbell approach. But we might be more active rebalancing between the Growth and Value seesaw. Along these lines, if we see more weakness in Big Tech (under the guise of "long duration" assets succumbing to higher interest rates), we will start to put back on some of the exposure we have recently trimmed.

Another dilemma is what to make of investor positioning. The monthly Fund Manager Survey from Merrill Lynch reinforced every thought we have had about this being an overly crowded market (which, ironically, is a consensus view we think…call it financial cognitive dissonance). Sentiment on global growth is at an all-time high. Equity and Commodity allocations are the highest since 2011. Only 13% say we are in a bubble. The misleading "cash level" is at an eight-year low (no such thing as a "cash level" in aggregate!). Merrill sums it up nicely by writing, "the only reason to be bearish is there is no reason to be bearish." And they politely point out that the last time those Equity and Commodity allocations hit their highs was the last time both had negative annual returns.

And how dare we not mention the $1.9t stimulus coming down the pipeline or the Fed's commitment to fueling the market? Normally stories that are beaten to death follow the path of "buy the rumor and sell the news." But this mantra applies to one-off or single action news items. But both the fiscal and monetary stimuli (apparently Larry Summers has already been excommunicated from the Democratic party for daring to suggest a "relief" package is more appropriate than a "stimulus") are the gifts that keep on giving…literally.

- It looks like interest rates are just normalizing

Looking back at the interest rate question, Yardeni Research presents a simple yet interesting chart. Below is a comparison between the Citi Economic Surprise Index (CESI, which we often cite) and the running 13-week change in the 10-year interest rate. When economic data is strengthening (at least compared to expectations, recall the CESI is a diffusion index which resets), interest rates increase with it. But obviously this linkage broke in 2020 as interest rates decreased while economic data improved dramatically off the government-induced lockdown-shock. But now we are seeing the two lines converge. Normalized economic data is still improving/surprising while interest rates have been "freed" to move to a market-clearing level (many have thought that the Fed would target the yield curve…keep short rates low and move long rates higher…the Fed resisted this notion on the surface, but clearly, they are not actively trying to combat this move either.) Our synopsis: We are not worried about interest rates (yet…the ultimate caveat).



- Even the inflation data is confusing

Producer Price Inflation increased in January at a 2% annualized clip compared to 1.2% in December (the "core" reading stripping out food and energy). On the surface, this gives the proponents of wide-based inflation some ammunition. But the reality is much of this increase has come in the form of exactly what we are expecting: hard assets. With slack in the labor market (lots of people not working) and productivity still increasing, we do not expect consumer inflation.

Barron's noted an interesting trend in airfares. A flight from New York to Orland currently costs $89. This same flight in July costs $179. And it jumps to $349 in December. The logical explanation is a return of demand as people either are expecting a full vaccination rollout…or virus-fear exhaustion. But what these forecasts are possibly missing is the new pricing model being used by airlines. That is, fares are now fully refundable without penalty. Customers are booking flights now at the new prices with the option to either cancel or get a cheaper flight down the road. The airlines as a whole are probably dead money for a while. But we are thinking about some long exposure targeting domestic tourism/vacation travel which probably has pent-up demand waiting to be unleased (unlike international or business travel)

- Housing is still rolling despite interest rates

The Housing market Index ticked higher in February after some mild softness in December and January. To phrase it more accurately, this date point has been sitting near its all-time high for six months now. Recall this is the survey of homebuilders, so momentum is always apparent in their responses (good times are here to stay, or the world is coming to an end). All facets of the survey (sales of new homes, sales of new homes expected in the next six months, and traffic of prospective buyers) point to continued strength. The only potential hiccup is seen in input costs and/or logistics (lumber prices =Producer Price Inflation). Slightly higher mortgage rates do not even register as a slight worry about demand. Elsewhere, the Biden administration has extended the ban on home foreclosures until June 30. Just like Bud Fox's boss, Lynch, once said, "Somebody's gotta pay, and it ain't gonna be me."

- Damn, it is cold! GameStop has nothing on spot Natgas prices!

We learned the power and danger of commodity markets back in April when spot and short-dated futures prices for crude oil plunged into negative territory. With the US government-induced demand-destruction and the Saudi and Russian-induced oversupply, the absolute lack of storage meant you had to pay someone to take away your oil. Well, we have just experienced the opposite phenomenon in the natural gas market. With the polar-vortex about to sweep the country including the gas producing Permian basin, utilities and other on-demand users of natural gas had to secure supply before the Washington's Birthday long-weekend. Despite March futures for natural gas trading around $3/MMBtu ($3 per million Btu), gas at the OneOK Gas Transmission hub in Oklahoma sold for $600/MMBtu. With the frigid cold seemingly lasting forever, natural gas for immediate delivery (spot) traded at $1250/MMBtu on Wednesday. Now that is a short squeeze!

This is mostly worthy of a Quick Hits mention. But this squeeze had real world implications. Texas is the most deregulated electricity market in the US. The Dallas Morning News wrote, "Homeowners and businesses churn power providers like credit cards." While we hope this somewhat antiquated practice (churning credit cards) is behind most, switching electricity providers frequently is just smart. With this oversupply (of providers) comes pricing innovation. One of the recent entrants, Griddy, promised to pass on the wholesale prices it gets with a markup of only $9.99/month. Well, when the wholesale electricity market hits $9,000 per megawatt-hour (pre-freeze state average was $0.12 per kilowatt-hour which is $12 per megawatt hour), that $250 monthly bill just jumped to $18,750. Griddy, to its credit, was imploring its customers to flee to other providers.

- Chart Crime of the week

This is not a crime but rather an oddity. A noted macro investor, Raoul Pal, points out that equities still look pretty cheap relative to the size of the Fed's balance sheet. His main thrust is to push Bitcoin as a means for poor people to get rich (out there, but hey, his point is that poor people have no other chance…risky but maybe). But we have not seen the simple charting of the market in these terms. It just reinforces our belief that the Fed is behind this move…and the Fed can stop the music.

- ➢ Quick Hits
  - When asked if Uber would consider buying Bitcoin, the CEO responded “No, we want to keep our cash safe.”
  - GameStop could not sell equity during the frenzy because it was essentially in a quiet-period right before earnings.
  - Propane prices have surged because of outdoor heating lamp usage.
  - A 1968 law changed the day Washington’s Birthday was celebrated. There is no such thing as President’s Day.
  - One of the 44 schools in San Francisco that is slated to have its name changed is Sanchez Elementary. But now the school board’s School Names Advisory Committee (yes, that is real) is having second thoughts. Sanchez was not a devilish Spanish missionary in the 1800s as originally suspected. Instead, he was the eighth mayor of San Francisco.
  - The San Francisco school board delayed a vote on reopening schools because it had more pressing business (see above).
  - Chinese president Xi supposedly squashed the Ant IPO (the financial service spinoff from Alibaba) last year because some of his political opponents were secretly large holders of stock.
  - A Chinese court has ruled that an accidental payment made by Citigroup to Revlon creditors must stand. Oops we mean a New York court. Bloomberg says the judge relied on the “finders’s keepers” precedent.
  - Carnival Cruise Lines borrowed money last April at 11.5% with a ship pledged as collateral. This week, Carnival issued bonds at 5.75% with no collateral.

Trading: Merle Haggard once sang "I wish the buck were still silver." We think this could be a running theme. Not only did we add to our silver long, but we also have more confidence in our large-cap stocks that make some money overseas. The USD has bounced a bit lately against a basket of currencies. But we think this is mostly non-Fx traders getting pushed out of short-term positions ("tourists" as they care called in macro land). We expect continued USD weakness which should translate into better earnings for multinationals. And since mgmt. teams have already warned against USD *strength*, we think this is a free option. (Of course, this is not to say we believe in International growth over US growth.) Otherwise, we have boosted our bias to Recovery stocks slightly over Lockdown/Virus/Work-From-Home stocks. But as we have mentioned, we like having a balance we can trade against when the market leans too far to one side. As a random indicator, we like to buy Chewy when it sells off with GameStop.

TSLAQ: One person owns 28% of all Dogecoin. This holding of this nonsensical crypto is worth $2.1b. Or it at least it was before it fell 33% in the last week. Yeah, it was a quiet week in Tesla land. Of course, a quiet Tesla is good for us as that means the stock is not rallying like crazy (we recently entered into a small short). Alas, the profitless Tesla is now a benchmark for the market given its massive size. So we are being careful for what we wish.

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